THE BOND BUYER

REGIONAL NEWS

Fitch Hits St. Louis Hard

By Yvette Shields
June 2, 2016

CHICAGO – St. Louis' issuer default and Municipal Finance Corp. ratings took three-notch tumbles over negative trends and Fitch Ratings application of new criteria in assessing tax-supported debt.

Fitch this week lowered the city's issuer default rating to A-minus from AA-minus and its MCF rating fell to BBB-plus from A-plus.

The action directly impacts $126 million of taxable pension funding leasehold revenue bonds from a 2007 issue, $6.5 million of similar bonds from a 2008 issue, and $21.4 million of 2008 juvenile detention center leasehold revenue bonds. All are now rated BBB-plus with a stable outlook, one notch below the issuer default rating that reflects the risk of appropriation. Fitch does not rate the city's outstanding debt, but it would likely be tied to the issuer default level, Fitch said.

The bonds are backed by an annual appropriation pledge. The city has also covenanted to dedicate proceeds from its half-cent public safety sales tax to pay debt service on the pension related bonds and the bonds are also backed by a pledge of essential city assets such as fire stations.

"Fitch's rating action reflects a combination of negative credit trends and the application of Fitch's revised criteria for U.S. tax-supported ratings released on April 18, 2016," analysts wrote in the report. "St. Louis's persistently narrow reserves well into an economic recovery, coupled with the absence of a plan to restore general fund reserves to levels consistent with the city's policy targets, have reduced Fitch's assessment of the city's financial flexibility under the revised criteria."

Fitch is worried over the city's prospects in the event of a moderate economic downturn in the next year or two.

Fitch expects that the city would defer capital spending and trim its workforce but they could fail to balance the city's books. The city has just limited room to defer capital spending given it's already large backlog of deferred capital projects.

"The city could be confronted with the unpalatable choice of going to voters to request either tax increases or significant debt issuance to pay for needed capital improvements," Fitch said. "Alternatively, the city may decide that continued deferral of critical capital projects is preferable to higher leverage, voter-approved tax increases, or headcount reductions that reduce services to levels the city administration views as unacceptable."

During prior downturns, the city has turned to municipal service fee and charge hikes and won voter approval for tax hikes, Fitch noted.

The rating remains sensitive to declines in general fund reserves, sharp reductions in liquidity, or to a prolonged economic downturn that depresses taxable values and tax revenue growth. The city is also sensitive to the revenue shock that could occur if the city's earnings tax, its largest source of general fund revenue at 32% fails to win voter renewal. Voters renewed it this year and it will come up again in 2021.

City comptroller Darlene Green sought to highlight that the rating change stems from a change in Fitch criteria that views for the first time voter authorization of the earnings tax as a negative. She also stressed that the city has been proactive in last year commissioning a 10-year strategic financial plan.

"The city proved its financial resilience during the most recent economic downturn," Green said in a statement. "But the city would be smart to strengthen its financial resiliency for the future by increasing reserves and seeking legislation to remove the earnings tax reauthorization mandate."

Moody's Investors Service last summer downgraded the city's general obligation rating to A1 from Aa3, its lease-revenue debt for essential services to A2 from A1, and its non-essential rating lease rating to A3 from A2 due to the city's fiscal challenges and in part also because of revised credit criteria. Standard & Poor's rates the city's GOs A-plus and its appropriation debt A.